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Comments: CalEPA Climate Action Team Cap and Trade Program Design Options Overview, October 24, 2005, Request for Comments

Dear Ms Tutt and Mr. Gibbs:

BP West Coast Products LLC appreciates the opportunity to comment on the CalEPA Climate Action Team Cap and Trade Program Design Options Overview, dated October 24, 2005. Attached is BP West Coast Products LLC response to CalEPAs request for comments. BP West Coast Products LLC is part of BP plc (BP). BP is the single, global brand formed by the combination of the former British Petroleum, Amoco, ARCO, and Burmah Castrol. BP's major operations in the United States consist of oil and gas exploration, production, refining, chemicals, commercial products, gas trading and solar energy. In California BP has more than 6,000 employees, assets of $3.5 billion and we market gasoline under the ARCO brand.

Climate change mitigation is a long-term challenge that will require sustained global action and investment over many decades. For maximum effectiveness, a cap and trade program should be implemented with national or broad regional coverage – enabling the market to take advantage of the value of economy of scale and overcome some of the complications associated with narrowly

focussed programs, such as the issue of leakage. If a cap and trade program is introduced in California, it must be designed to maximize compatibility and linkage with other existing or emerging programs and international regimes.

Please don't hesitate to contact me should you have questions or need additional information.

Sincerely,

Denise Michelson

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cc: Alan Lloyd, Secretary, CalEPA
Anne Baker, Deputy, Secretary CalEPA

ATTACHMENT
BP Response to Section 4: Request for Comment
Cap and Trade Program Design Options Overview
October 24, 2005

4.1 Scope

Note: No response to Question 2.

1. If the scope of the emissions cap is defined as in-state electric power generating facilities without also covering imported electricity in some manner, there will be an incentive to import more electricity in the future to avoid the emissions cap. Is this incentive to avoid the cap by importing electricity significant enough to make this option (in-state electric power generation only) a poor choice?

The question above, addressing leakage, is one of the reasons why BP believes it is necessary to have a broad regional program. BP would encourage California to advocate for a national or broad regional regime.

3. One approach to defining the scope of the cap and trade program is to include specific sectors. Key sectors identified to date are: electric power generation; refining; oil and gas extraction; landfills, and cement production. Are these sectors good candidates? What additional should sectors be considered?

The primary selection criteria for including any given sector in a greenhouse gas reduction effort should include such factors as the sector's relative contribution to greenhouse gas emissions, the ability to develop accurate estimates of sector emissions and reductions, and the means to accurately measure and verify emissions in the sector. To avoid overly burdensome costs, there must be a realistic threshold whereby small emissions installations (within a sector) can be excluded.

4. Three approaches for defining the scope of the cap and trade program have been identified: (1) sectors; (2) fossil fuel stationary combustion sources; and (3) consumption of all fuels. Which approach is preferred? What factors are important in making this determination?

The scope of the program should be based on a sector approach, which helps create a level playing field for the included sectors. A combustion-source system could be used in combination with a sector approach to capture high emissions sources (e.g. greater than 25 MW equivalent) not included in the covered sectors.

5. If multiple sectors are included in the scope, are policies required to accommodate the differing cost structures of the varying sectors? For example, as regulated entities, LSEs have different cost structures than the other sectors.

A key success factor in a cap and trade program is a disparity in marginal costs of abatement—either between companies or sectors—which leads to a "least cost" solution for all participants. Accordingly, sector-specific allocations should address other issues such as sector-specific regulations that will impact trading program effectiveness (e.g. the production of cleaner fuels is more energy and emissions intensive).

6. If multiple sectors are included in the scope, are policies required to address the wide variation in the sizes and resources of various entities that would be included in the program?

See response to Question 3 above.

4.2 Allowance Distribution

7a) Do you support selling allowances through an auction, and if so, why?

BP supports a free distribution of all allowances. A free allowance avoids tying up large amounts of capital in the initial stages of the program. This capital would be better spent on emission reduction projects. A free distribution would also ensure that allowances would go directly to program participants and not to other parties interested in financial speculation or manipulation of the market.

7b) If allowances are sold, how should the revenue be used?

BP does not support the initial sale or auction of allowances. It is ultimately more efficient to let the market forces reallocate the funds through the system (i.e. applied to create GHG reductions).

7 c) If allowances are allocated, what method do you prefer for making the allocation (baseline emissions or output)?

BP believes that wherever possible, and where the information is available, allocation of allowances should ideally be based on a benchmarked output/CO2 emissions process to encourage more efficient processes and technologies. However, in practical terms BP recognizes that it may be necessary to use a 'grand-father' approach, based on historical emissions, in the early stages of implementation.

7d) If allowances are allocated, what method do you prefer for handling new sources?

New sources should be required to buy allowances in the market. New entrants (i.e. those which are not committed financially to investment) with little historical data will need to construct a baseline using the most recent data with proper consideration of start-up emissions. Likewise, BP believes allowances resulting from plant closure or shutdown should be retained in the system until the end of the compliance period. Both these program options will stimulate the market and increase trading.

8) Should allowances be allocated one time, or periodically? What factors are important in making this determination?

A primary goal of a cap and trade system is to encourage investment to reduce emissions. Accordingly, the allowance allocation period should match the business investment cycle to maximize certainty. A ten-year allocation period is recommended, with annual allowance allocations.

9) Should the compliance periods (during which sufficient emission allowances must be held to cover emissions) be defined as individual years? Alternatively, should longer compliance periods be considered, such as successive five year periods?

Compliance periods during which sufficient emission allowances must be held to cover emissions should not be defined as individual years. A multi-year comprehensive compliance period of at least 3 - 5 years should be considered, with allowances for banking and borrowing between periods.

4.3 Offsets

10a-b) Should offsets be included in the design of the cap and trade program?

Climate change is a global issue and all reductions in GHG should be valued as long as they are real and sustainable. For some industries and source types, there is no effective CO_2 control equipment as was available in the Acid Rain and ozone programs. Unconstrained offset development can serve as a surrogate to fill the role of controls. Offsets may also be a way to use market incentives to engage the non-regulated community and others to stimulate creative and inventive GHG reduction opportunities and lower the overall cost abatement cost of the program.

As long as the offsets can be demonstrated to be real and sustainable, with third party verification, BP believes that there should be no limits on 1) geographic location, 2) project type, or 3) usage to achieve reduction commitments. For practical reasons, regulators may need to manage the introduction of some offset credits in the short term to avoid disrupting confidence in the market.

4.4 Other Program Design Considerations

11) Should the cap and trade program be limited to CO_2 emissions from fossil fuel combustion? What other gases and emissions sources should be included?

In the interests of simplicity, only CO_2 should be included initially. The other Kyoto GHGs should be addressed separately from the cap and trade program. Other programs, e.g. direct regulation, may be more suitable to control these gases. The appropriateness of applying emissions trading to each of the Kyoto GHGs needs to be evaluated separately for each gas. For the more "exotic" gases it is likely that the transaction costs and complexity associated with their incorporation (i.e. lack of emission calculation methods, complexity measuring, monitoring and reporting especially fugitive emissions) will outweigh the benefits, at least initially.

12) Should limits be imposed on how allowances are traded?

There should be no limits imposed on trading of allowances. An unconstrained market will insure emission reductions at the lowest, cost-effective price.

13) Do you have any concerns regarding banking and borrowing?

BP supports the use of banking and borrowing in a cap & trade program. Many regulated sources will have few or limited opportunities to reduce GHG emissions. Flexible mechanisms like banking and borrowing are two options that can be used to increase the cost-effectiveness of reducing emissions. Banking and borrowing have also been shown to enhance the environmental performance in the Acid Rain program by improving flexibility and the ability to handle uncertainties.

14) Do you have a preference for which organization is responsible for receiving and verifying greenhouse emissions reports if they were to become mandatory?

A publicly transparent, independently verified registry of GHG emissions will assist in the establishment of emissions baselines but also promote public awareness and stimulate broader private sector participation. Further, we believe that standardization of calculation methodologies and reporting protocols are crucial in the ability to link state, national and international registries. The California Climate Action Registry (Registry) protocols have become widely recognized standards for measuring and certifying GHG

4.4 Other Program Design Considerations (cont.)

emissions, and are consistent with the WRI/WBCSD protocols used in the EU ETS and the proposed RGGI system. BP supports the Registry as the central repository for California GHG emissions.

15) What option(s) do you prefer for addressing non-compliance with the cap?

The program should adopt an approach similar to the Acid Rain program. It should include monetary penalties for noncompliance and require that emissions be offset in the following compliance period.

16 & 17) What design elements best address Environmental Justice Issues?

Continued engagement with the Environmental Justice advocates is essential as the program evolves. This helps to facilitate the process of identifying community concerns. Also, before any program is undertaken, a holistic analysis should be undertaken to ensure that negative collateral impacts on air quality would not result from the GHG reduction program.